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INTERNATIONAL MONETARY FUND

Research Department

RECENT MONETARY REFORM IN AUSTRIA

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1. Developments Before the Reform

At the time of Austria's reestablishment as an independent country after the war, its economic life had been severely disrupted. Many of the abnormal conditions arising from the war and postwar political arrangements among the Allies have not yet been removed. In particular the division of the country into four occupation zones and the fact that the government is still not in a position to exert its full authority have serious repercussions on the Austrian economy. Any law passed in the Austrian Parliament is submitted for the approval of the Allied Control Council. In the absence of a unanimous decision by the Allies, a period of 31 days must elapse before the law becomes effective.

The production level, though steadily improving, is still comparatively low. According to recent reports, it does not exceed two-thirds of the prewar level and in many important branches of the economy is far below that mark. Industrial production has been hampered by the irregular supply of coal, power and raw materials. Undernourishment of workers, poor management, disrepair of equipment, etc. contributed to a severe reduction of productivity. Agricultural production suffered from lack of fertilizers, shortages of farm implements, farm labor, etc. The food situation has been strained from the beginning in spite of considerable UNRRA deliveries and post-UNRRA relief aid from the United States. Since the end of the war, the population depending upon food rations has never been able through the ration system to obtain more than half the normal calorie content. Under these circumstances it is not surprising that the black market has been patronized practically by the entire population within the limits of their incomes or savings. The presence of large numbers of occupation troops and other foreign personnel has also been an unfavorable factor. The persistent scarcities of food and other consumer goods have made it impossible for the Government to control prices effectively and to abolish the black market. The inability of the farmers to secure needed supplies of industrial goods through official channels reduces the incentives for agricultural production and leads to the diversion of food supplies into the black market and to a flourishing barter trade between country-side and cities. This is particularly true for Vienna where more than one-fourth of Austria's total population lives.

A further element in the abnormal situation is the fact that a large number of Austria's industrial and commercial enterprises in the Soviet occupation zone, which are classified as "German assets", are under the exclusive control of the Soviet authorities. A large part of their output is withheld from Austrian consumption, the management is subject to directions from the Soviet authorities, and it is known that a considerable part of current production is exported on Soviet account.

Excessive money supply and lack of confidence in the post-war currency strengthened the disturbing effects of these factors on the whole economy. The volume of cash holdings and bank deposits had enormously increased while Austria formed a part of the German war economy. After liberation, there was a further influx of reichsmark notes before the schilling was reintroduced as the national currency. In December 1945, reichsmark notes and Allied Military schillings in circulation on Austrian territory were exchanged into schillings at par, with the limitation that all amounts exceeding 150 schillings per person had to be deposited in the banks. Since the Government was then aware that Austria had inherited its full share of the enormously inflated German money supply it decided, as a preliminary measure to be followed by a more comprehensive currency reform, to reduce the money supply by blocking 60% of all deposits; the ultimate fate of these blocked accounts, however, remained unsettled. In the last two years, a steady increase of the note circulation was due mainly to circumstances beyond the control of the Austrian Government, since a substantial part was caused by the payment of occupation costs; the note circulation was also increased by withdrawals from free, and to some extent, in hardship cases, from blocked accounts.

Throughout the postwar period, the purchasing power in the hands of the public remained too large in relation to the severely reduced supply of goods. While wage earners and fixed income groups gradually exhausted most of their savings, other population groups, including black market operators, vastly increased their cash holdings, so that at one and the same time monetary stringency in some sectors of the economy existed alongside monetary abundance elsewhere. Although in principle price control and rationing were continued, the government was compelled to grant price increases, first piecemeal and later on a general basis; these price adjustments were subsequently followed by wage increases. During the last six months, these controlled price and wage spirals were greatly accelerated and assumed major proportions. While in two years (April 1945-April 1947) the cost of living index, computed on the basis of official prices, had increased by only 33 per cent, the increase in the next three months amounted to 55 per cent, and was followed in the subsequent quarter by another increase of 43 per cent, as a result of a price and wage agreement concluded for the period August to November 1947. By that time it was clear, that the hoped for stabilization of the price and wage levels had not been achieved. On the contrary, the violent price movements during the preceding six months intensified the flight from the currency, and the abnormal demand for real assets threatened to paralyze the whole economic system. This pressure of events prompted the Government to undertake immediately the long postponed completion of the currency reform, and to resort to radical measures in order to remove the inflationary pressure originating in the excessive money supply.

The postwar schilling is almost a pure paper currency and confidence in its value is not supported by any appreciable gold or foreign exchange holdings. When, in 1938, Austria was annexed by Germany, the entire gold reserve of the National Bank was taken over by the Reichsbank. Only a small part has been returned, but it is expected that the present insignificant gold reserve of the National Bank, amounting to $5 million, will soon be increased by another $30-40 million to be distributed by the Inter-Allied Reparations Agency as Austria's share from the "gold pot." While the absence of a sufficient gold reserve had already impaired confidence in the stability of the currency, recurring rumours of an impending currency reform caused further alarm in the generally disturbed monetary situation. These and other psychological factors played an important part in the acceleration of the inflationary development.

2. The Main Provisions of the New Currency Law

On November 20, 1947, the Austrian Parliament passed the "Law for the Protection of the Currency" in order to reduce the money supply to suitable proportions. The objective of the law is the preservation of the purchasing power of the schilling within the framework of the present price and wage structure. The law did not take effect immediately but was subject to approval by the occupying powers. It was only on December 5 that the Allied Control Council gave its unanimous consent, whereupon the Austrian Government could proceed with the exchange operation which took place in the period from December 11 through December 24. The reform affects both the note circulation and bank deposits. With some important exceptions to be discussed later, the exchange of bank notes is carried out at the ratio of 3 to 1. The amount presented for exchange by each person or firm is communicated to the Treasury. This procedure makes possible an examination of holdings from the point of view of taxation which is regarded as an important by-product of the whole operation. As to bank deposits, the reform affects most drastically blocked accounts representing funds deposited before April 1945 (3.4 billion in the National Bank and 8 billion schillings in other credit institutions), which will be cancelled, with some exemptions in cases of hardship. Funds deposited during the period April-December, 1945, "old and conversion accounts" will be converted into interest-bearing government obligations which can be used at their full nominal value for the payment of a capital levy. Funds deposited after December 1945, will not be reduced, but only 50 per cent of each deposit remains free, while 25 per cent will be blocked for six months, and another 25 per cent for nine months. Any net increase in a deposit between November 12, 1947, and the date when the reform came into effect is treated as a holding of bank notes, and converted at the rate of 3 : 1. In the absence of such a provision, persons who had deposited notes in their banking accounts after November 12 would have evaded the intention of the reform.

The main exceptions from the general rule are:

(a) Cash holdings of 150 schillings per person in bank notes will be exchanged at par.

(b) The first 1,000 schillings of funds deposited after December 1945, will not be affected by the monetary reform.

(c) An amount of 2,500-3,500 schillings will be freed in installments from blocked accounts in certain hardship cases, defined as persons with inadequate income unable to work owing to old age, ill health, or other reasons, returning war prisoners, etc. Blocked accounts containing not more than 100 schillings are free of any restrictions.

(d) Farmers who have fulfilled their obligations regarding quota deliveries from this year's harvest will not be affected up to the value of their deliveries.

(e) Blocked holdings of government agencies will be reduced by 25 per cent while another 25 per cent will be blocked for one year.

(f) Certain privileges apply to the holdings of the occupying powers. Precise information on this point is not yet available. According to press reports each of the Allied powers will receive 12 million schillings of new currency to pay off the holdings of military personnel. In addition, the outstanding share of the USSR in the occupation costs for the third quarter of the year, 8 million schillings will be paid in the new currency. Under a special agreement signed by the Austrian Government with the Soviet occupation authorities, a part of Soviet currency holdings, namely 490 million schillings, will be exchanged at par. The rest of their cash holdings, however, will be reduced by two-thirds like other holdings. The total cash holdings of the Soviet authorities and Soviet-controlled enterprises is not known, but it is believed that after the reform they will have about 1,000 million schillings. The Russian demand for special consideration was based on a claim for repayment of a loan of 600 million reichsmarks granted to the Austrian Government in 1945. It was agreed that the amount of 490 million schillings, mentioned above, will not be paid at once, but will be released in installments over a period of two years. The Austrian Government regarded the deal as an acceptable compromise which led to the speedy approval of the currency reform by the Soviet authorities.

3. Estimated Reduction of the Money Supply

The effect of the monetary reform on the money supply as anticipated by the National Bank is shown in the following table:

Note Circulation and Bank Deposits Before and After Reform.
(billion schillings)

	Before Reform	After Reform (estimate) Free	Temporarily Blocked	Total
Note Circulation	6.0	3.0		3.0
Deposits with National Bank				
Free deposits:				
of credit institutions	1.0	1.0		1.0
of gov. agencies	1.6	0.8	0.4	1.2
of others	0.4	0.2	0.2	0.4
Blocked deposits	3.4	--	--	-- 1/
Sub-total	12.4	5.0	0.6	5.6
Deposits with other Credit Inst.				
Blocked accounts	8.0	0.8		0.8 1/
Old and conversion accounts	2.3	--	--	-- 2/
Free accounts	2.8	1.4	1.4	2.8
Holdings of gov. agencies	2.0	1.0	0.5	1.5
Sub-total	15.1	3.2	1.9	5.1
Total	27.5	8.2	2.5	10.7

1/ Cancelled, with the exception of hardship exemptions.

2/ Converted into interest-bearing government obligations.

The note circulation will be reduced by one-half from about 6 billion to 3 billion schillings. Total deposits in credit institutions other than the National Bank will be reduced from 15.1 billion schillings to 5.1 billion, of which 1.9 billion will remain temporarily blocked for the next six or nine months. Deposits are thus more drastically reduced than notes, but it should be taken into account that the greater part of the reduction is of blocked accounts which were already immobilized. The money supply after the reform will be roughly three times as large as in the prewar period when the currency circulation was below 1 billion and deposits about 3 billion, which may be considered appropriate in view of the correspondingly higher price and wage level.

4. Probable Effect on the Austrian Economy

The deflationary effect of the monetary reform will be strong. The substantial reduction of the cash holdings of business enterprises and the ensuing monetary stringency is expected to result in (1) Appearance of hoarded goods on the market and, therefore, general improvement in supply conditions; (2) More effective distribution of the labor force since employers will no longer be able to retain superfluous labor, badly needed elsewhere; (3) Increased pressure for greater productivity and rational cost-price adjustments; (4) Elimination of the black market in many goods, and a very substantial general reduction of black market prices; (5) Increased supply of necessary consumer goods and elimination of unnecessary production of luxury items.

The quantitative reduction of the money supply, and the redistribution of purchasing power between various population groups, will have a fundamental effect on future demand conditions. Money wages will be maintained on the same level as before the currency reform; since the bulk of current income payments will not be reduced, the purchasing power of the working population will be preserved, which is one of the main objectives of the reform. On the other hand, large amounts of hoarded bank notes and excessive cash balances which were extensively used for black market operations will be wiped out. These funds contributed most to the existing inflationary pressure. Their elimination was, therefore, an indispensable prerequisite for the achievement of price stability. Whether the distribution of savings deposits has been affected in the right direction from the point of view of social welfare appears less certain. No distinction has been made between holdings which originated in the prewar period and those acquired during the war. By the indiscriminate cancellation of blocked deposits, of which 6.1 billion schillings were in savings accounts, genuine savings were probably at least as strongly affected as speculative gains. It is therefore important that the government intends to supplement the monetary reform by various tax measures, now in preparation, such as a capital levy and a tax on capital gains. Since the monetary reform affects only holdings in bank notes and bank accounts, assets in real estate and other property have not yet been touched. According to press reports, the application of these tax measures to this group of property owners is contemplated in order to secure equality of sacrifice.

The full effect of the currency reform will be felt only after some time has elapsed, and supplementary measures in the field of taxation have been carried out. Before theccurrency reform and particularly in the interim period before approval by the Allied Control Council, merchandise was generally withheld from the market while at the same time an enormous buying spree swept the population. After announcement of the reform there was a large-scale movement of repayment of debts of all kinds, including taxes. Debtors tried to use the time interval to shift the burden of loss to their creditors. The fact that cash holdings deposited after November 12 were generally treated like bank notes is reported to have worked out to the detriment of industry and legitimate trade, because many payments were received after the deadline for merchandise bought on credit or goods for which orders had been placed before the reform.

It is probable that after the reform both the market mechanism and production will be favourably influenced by the sharp reduction of liquid funds, and that hoarded merchandise will quickly reappear on the market. The increased supply of goods will have a stabilizing influence on prices. Although the black market will not be completely wiped out as long as the low production level (estimated at about 60 per cent of prewar) continues, a substantial decline of black market prices is anticipated, once the excess money supply has been removed. On the other hand, the deflationary development is also going to hinder production, and many enterprises will have to rely on bank credit in order to make up for losses of working capital. A great deal, therefore, will depend on appropriate action by the government supplementary to the currency reform. Effective credit control measures will afford an opportunity to influence production in the right direction, which is the urgent task the Government will have to undertake in order to make the currency reform a success and prevent new inflationary developments.

Objections against the reform were raised by the Association of Bankers, by the representatives of industry, and by Dr. Kienbock, adviser to the National Bank. Some of these objections had to do with the fact that the waiting period between the adoption of the law in Parliament and approval by the Allied Control Council would introduce an element of confusion into the Austrian economy. It was also pointed out that the bulk of the existing money supply had already been taken out of circulation by the extensive blocking measures of December 1945, and that most of the inflationary pressure had already been absorbed by a substantial increase of the official price level. The maldistribution of purchasing power (cash holdings of black market operators, speculators, etc.) rather than excess holdings of the general population was, according to the critics, the heart of the problem, and the mechanical reduction of the money supply would not correct this maldistribution. The main weakness of these arguments lies in the fact that no practical alternative to the government measures could be offered under prevailing circumstances. Moreover, the previous policy of price and wage adjustments without curtailment of the money supply had proved to be a failure. The admission of the critics that the maldistribution of purchasing power was an important factor in the situation made a severe reduction of the money supply more rather than less desirable.